2011

# Quarterly Financial Report

Containing:

- Independent auditor’s review report
- Interim condensed consolidated financial statements as at and for the three-month period ended March 31, 2011

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NETIA

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**Report on review of interim condensed consolidated financial statements to the Supervisory Board of Netia S.A.**

1. We have reviewed the attached interim condensed consolidated statement of financial position of Netia S.A. ('the Group') as at March 31, 2011 and the related interim condensed consolidated income statement, interim condensed consolidated statement of comprehensive income, interim condensed consolidated statement of changes in equity, interim condensed consolidated statement of cash flows for the 3 months period then ended and notes to interim condensed consolidated financial statements ('the attached interim condensed consolidated financial statements').

2. Management is responsible for the preparation and presentation of these interim condensed consolidated financial statements in accordance with International Financial Reporting Standard IAS 34 'Interim Financial Reporting' as adopted by the European Union ('IAS 34'). Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

3. We conducted our review in accordance with International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

4. Based on our review, nothing has come to our attention that causes us to believe that the attached interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34.

5. The convenience translations are disclosed as part of the interim condensed consolidated financial statements. The convenience translation for the 3 months period ended March 31, 2011 has been presented in Euros, as a matter of arithmetic computation using the official rate of the National Bank of Poland at March 31, 2011 of PLN 4,0119 to EUR 1.00. We have not reviewed these translations and accordingly we do not report thereon. The Euro amounts presented in these interim condensed consolidated financial statements should not be construed as a representation that the PLN amounts have been or could have been converted to Euro at this rate or at any other rate.

Ernst & Young Audit Sp. z o.o.

Ernst &Young Audit sp. z o.o.

Warsaw, 4 May 2011

NETIA S.A.

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three-month period ended March 31, 2011

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**NETIA S.A.**
**INTERIM CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION**
**as at March 31, 2011**

*(All amounts in thousands, except as otherwise stated)*

| | Note | March 31, 2011 (PLN) | December 31, 2010 (PLN) | Convenience Translation March 31, 2011 (EUR) |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Non-current assets** | | | | |
| Property, plant and equipment, net | 5 | 1,473,665 | 1,475,682 | 367,323 |
| Intangible assets | 7 | 376,102 | 389,444 | 93,747 |
| Investment property | 8 | 25,933 | 45,084 | 6,464 |
| Deferred income tax assets | 14 | 59,017 | 52,762 | 14,710 |
| Available for sale financial assets | | 115 | 10 | 29 |
| Long term receivables | | 218 | 217 | 54 |
| Prepaid expenses and accrued income | | 9,805 | 10,508 | 2,444 |
| **Total non-current assets** | | **1,944,855** | **1,973,707** | **484,771** |
| **Current assets** | | | | |
| Inventories | | 7,120 | 11,393 | 1,775 |
| Trade and other receivables | | 163,407 | 139,691 | 40,730 |
| Tax Office receivables | 4 | - | 58,325 | - |
| Current income tax receivables | | 30 | 120 | 7 |
| Prepaid expenses and accrued income | | 38,108 | 37,876 | 9,499 |
| Derivative financial instruments | 9 | 117 | 117 | 29 |
| Financial assets at fair value through profit and loss | 9 | 1 | 1 | - |
| Held to maturity investments | 9 | 171,600 | 171,616 | 42,773 |
| Restricted cash | | 2,123 | 2,123 | 529 |
| Cash and cash equivalents | | 210,439 | 173,600 | 52,454 |
| **Total current assets** | | **592,945** | **594,862** | **147,796** |
| **Total assets** | | **2,537,800** | **2,568,569** | **632,567** |

Mirosław Godlewski
President of the Company

Piotr Nesterowicz
Member of the Management Board

Jonathan Eastick
Member of the Management Board
Chief Financial Officer

Tom Ruhan
Member of the Management Board

Grzegorz Esz
Member of the Management Board

Warsaw, Poland
May 4, 2011

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

*(All amounts in thousands, except as otherwise stated)*

| | Note | March 31, 2011 (PLN) | December 31, 2010 (PLN) | Convenience Translation March 31, 2011 (EUR) |
|---|---|---|---|---|
| **EQUITY** | | | | |
| Share capital | | 390,375 | 389,459 | 97,304 |
| Supplementary capital | | 1,599,580 | 1,599,299 | 398,709 |
| Retained earnings | | 246,213 | 269,258 | 61,371 |
| Other components of equity | | 38,729 | 39,530 | 9,654 |
| **Total equity** | | **2,274,897** | **2,297,546** | **567,038** |
| **LIABILITIES** | | | | |
| **Non-current liabilities** | | | | |
| Provisions | | 914 | 988 | 228 |
| Deferred income | | 20,014 | 21,619 | 4,989 |
| Other long term liabilities | | 8,098 | 9,264 | 2,019 |
| **Total non-current liabilities** | | **29,026** | **31,871** | **7,236** |
| **Current liabilities** | | | | |
| Trade and other payables | | 192,838 | 206,351 | 48,065 |
| Derivative financial instruments | 9 | 1,044 | 849 | 260 |
| Borrowings | | - | 31 | - |
| Current income tax liabilities | | 1 | 1 | - |
| Provisions | | 1,723 | 1,855 | 429 |
| Deferred income | | 38,271 | 30,065 | 9,539 |
| **Total current liabilities** | | **233,877** | **239,152** | **58,293** |
| **Total liabilities** | | **262,903** | **271,023** | **65,529** |
| **Total equity and liabilities** | | **2,537,800** | **2,568,569** | **632,567** |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

*(All amounts in thousands, except as otherwise stated)*

| | Note | Three-month period ended March 31, 2011 | Three-month period ended March 31, 2010 (Restated) | Convenience Translation Three-month period ended March 31, 2011 |
|---|---|---|---|---|
| | | (PLN) | (PLN) | (EUR) |
| **CONSOLIDATED INCOME STATEMENT** | | | | |
| **Revenue** | | **401,189** | **386,979** | **100,000** |
| Cost of sales | | (270,234) | (260,216) | (67,358) |
| **Gross profit** | | **130,955** | **126,763** | **32,642** |
| Selling and distribution costs | | (72,271) | (77,936) | (18,014) |
| General and administration costs | | (36,040) | (36,949) | (8,983) |
| Other income | | 4,714 | 4,913 | 1,175 |
| Other expenses | | (997) | - | (249) |
| Other gains / (losses), net | 12 | (311) | 2,771 | (78) |
| **Operating profit** | | **26,050** | **19,562** | **6,493** |
| Finance income | 13 | 3,282 | 2,763 | 818 |
| Finance costs | 13 | (222) | (4,892) | (55) |
| **Profit / (Loss) before income tax** | | **29,110** | **17,433** | **7,256** |
| Income tax benefit / (charge) | 14 | (52,155) | (3,081) | (13,000) |
| **Profit / (Loss)** | | **(23,045)** | **14,352** | **(5,744)** |
| Profit / (Loss) attributable to: | | | | |
| Owners of the Company | | (23,045) | 14,352 | (5,744) |
| Non-controlling interest | | - | - | - |
| | | **(23,045)** | **14,352** | **(5,744)** |
| **Earnings per share** (expressed in PLN per share) | | | | |
| - basic | | (0.06) | 0.04 | (0.01) |
| - diluted | | (0.06) | 0.04 | (0.01) |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

*(All amounts in thousands, except as otherwise stated)*

| | Note | Three-month period ended March 31, 2011 (PLN) | Three-month period ended March 31, 2010 (Restated) (PLN) | Convenience Translation Three-month period ended March 31, 2011 (EUR) |
|---|---|---|---|---|
| **CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME** | | | | |
| **Profit/ (Loss)** | | **(23,045)** | **14,352** | **(5,744)** |
| Cash flow hedges (equipment and construction contracts) | 9 | (240) | (451) | (60) |
| Income tax relating to components of other comprehensive income | | 41 | (25) | 10 |
| **Other comprehensive income** | | **(199)** | **(476)** | **(50)** |
| **TOTAL COMPREHENSIVE INCOME/ (LOSS)** | | **(23,244)** | **13,876** | **(5,794)** |
| Total comprehensive income attributable to: | | | | |
| Owners of the Company | | (23,244) | 13,876 | (5,794) |
| Non-controlling interest | | - | - | - |
| | | **(23,244)** | **13,876** | **(5,794)** |

*(All amounts in thousands, except as otherwise stated)*

| | | | Supplementary capital | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Note** | **Share capital** | **Share premium** | **Other supplementary capital** | **Retained earnings** | **Employee share option scheme** | **Hedging reserve** | **Total equity** |
| | | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** |
| **Balance as at January 1, 2011** | | **389,459** | **1,356,678** | **242,621** | **269,258** | **39,798** | **(268)** | **2,297,546** |
| Loss for the period | | - | - | - | (23,045) | - | - | (23,045) |
| Other comprehensive income | | - | - | - | - | - | (199) | (199) |
| Total comprehensive income | | - | - | - | (23,045) | - | (199) | (23,244) |
| *Employee share option scheme:* | | | | | | | | |
| - value of services provided | 10 | - | - | - | - | 617 | - | 617 |
| - issuance of series K shares | 10 | 916 | 303 | - | - | (1,219) | - | - |
| Cost of issuance | | - | (22) | - | - | - | - | (22) |
| **Balance as at March 31, 2011** | | **390,375** | **1,356,959** | **242,621** | **246,213** | **39,196** | **(467)** | **2,274,897** |

| | | | Supplementary capital | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Note** | **Share capital** | **Share premium** | **Other supplementary capital** | **Retained earnings** | **Employee share option scheme** | **Hedging reserve** | **Total equity** |
| | | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** |
| **Balance as at January 1, 2010** | | **389,277** | **1,356,652** | **-** | **247,984** | **34,201** | **(1,937)** | **2,026,177** |
| Profit for the period | | - | - | - | 14,352 | - | - | 14,352 |
| Other comprehensive income | | - | - | - | - | - | (476) | (476) |
| Total comprehensive income | | - | - | - | 14,352 | - | (476) | 13,876 |
| *Employee share option scheme:* | | | | | | | | |
| - value of services provided | 10 | - | - | - | - | 3,182 | - | 3,182 |
| - issuance of series K shares | 10 | 61 | 15 | - | - | (76) | - | - |
| Cost of issuance | | - | (1) | - | - | - | - | (1) |
| **Balance as at March 31, 2010** | | **389,338** | **1,356,666** | - | **262,336** | **37,307** | **(2,413)** | **2,043,234** |

*(All amounts in thousands, except as otherwise stated)*

| | Note | Three-month period ended March 31, 2011 (PLN) | Three-month period ended March 31, 2010 (Restated) (PLN) | Convenience Translation Three-month period ended March 31, 2011 (EUR) |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| **Profit** | | **(23,045)** | **14,352** | **(5,744)** |
| Adjustments for: | | | | |
| Depreciation and amortization | 5, 7 | 75,325 | 73,972 | 18,775 |
| Impairment charges for specific individual assets | 5 | 958 | - | 239 |
| Deferred income tax charge / (benefit) | 14 | (6,245) | 2,996 | (1,557) |
| Interest expense and fees charged on bank loans | | - | 2,838 | - |
| Other interest charged / (earned) | | (1,561) | (530) | (389) |
| Share-based compensation | 10 | 829 | 3,327 | 207 |
| Fair value (gains) / losses on financial assets / liabilities | | - | (697) | - |
| Fair value (gains) / losses on derivative financial instruments | 9 | (15) | 368 | (4) |
| Foreign exchange (gains) / losses | | (68) | 1,172 | (17) |
| Loss / (Gain) on disposal of fixed assets | | 49 | (3,196) | 12 |
| Gain on sale of investments | | - | 881 | - |
| Changes in working capital | 16 | 1,229 | (14,323) | 306 |
| Tax expense relating to prior periods | 4 | 58,325 | (59,586) | 14,538 |
| **Net cash provided by operating activities** | | **105,781** | **21,574** | **26,366** |
| Cash flows from investing activities: | | | | |
| Purchase of fixed assets and computer software | | (68,927) | (56,565) | (17,180) |
| Purchase of operational networks | | - | (818) | - |
| Proceeds from sale of fixed assets | | 94 | 1,540 | 23 |
| Purchase of subsidiaries, net of cash received | 6 | (573) | - | (143) |
| Purchase of treasury bonds / notes | | (38,324) | (38,487) | (9,552) |
| Receipts of treasury bonds / notes | | 40,000 | - | 9,970 |
| Sale of investments | | - | 3,395 | - |
| **Net cash used in investing activities** | | **(67,730)** | **(90,935)** | **(16,882)** |
| Cash flows from financing activities: | | | | |
| Finance lease payments | | (1,249) | (1,414) | (310) |
| Loan payments | | (31) | (347) | (8) |
| Payments of fees relating to bank loans | | - | (552) | - |
| **Net cash used in financing activities** | | **(1,280)** | **(2,313)** | **(318)** |
| **Net change in cash and cash equivalents** | | **36,771** | **(71,674)** | **9,166** |
| **Exchange gains / (losses) on cash and cash equivalents** | | **68** | **(826)** | **17** |
| Cash and cash equivalents at beginning of period | | 173,600 | 181,203 | 43,271 |
| **Cash and cash equivalents at end of period** | | **210,439** | **108,703** | **52,454** |

## 1. The Company and the Netia Group

Netia S.A. (the "Company" or "Netia") was formed in 1990 as a limited liability company under the laws of Poland and was transformed into a joint stock company in 1992. In 2003 a general meeting of shareholders adopted a resolution changing the Company's name from Netia Holdings S.A. to Netia S.A. The Company is incorporated and domiciled in Poland with its registered office located at ul. Poleczki 13, 02-822 Warsaw, Poland. The parent company is entered in the Register of Entrepreneurs kept by the District Court, XIII Economic Department of the National Court Register, Entry No. KRS 0000041649. The parent company was granted statistical REGON number 011566374. The parent company and other Group entities have an unlimited period of operation.

The interim condensed consolidated financial statements of Netia S.A. for the three-month period ended March 31, 2011 comprise the Company and its subsidiaries.

These interim condensed consolidated financial statements were approved for issuance by the Company's Management Board on May 4, 2011 and were subject to a review by an independent auditor.

The Company and its subsidiaries (together, the "Netia Group") is the largest alternative fixed-line telecommunication operator in Poland. The Netia Group provides various voice telephony and data transmission services. These services include switched, fixed-line voice telephone services (including domestic long-distance, international long-distance and fixed-to-mobile services), Integrated Services Digital Network ("ISDN"), Voice over Internet Protocol ("VoIP"), voice mail, leased lines and frame relay and MPLS services. The Netia Group also offers wholesale services (including the wholesale termination of in-bound traffic, ducts, dark fiber and co-location services), services based upon intelligent networks (free phone, split charge and premium rate services) and provides broadband Internet access with ADSL technology. These services are offered over Netia's own copper or fiber networks and, selectively, over network facilities leased from other operators.

Since 2006, the Netia Group has been providing voice and broadband services using WIMAX technology running over 3.6 – 3.8 GHz frequencies that were acquired by the Group in 2005.

Taking advantage of the opportunities arising from changes in the regulatory environment, the Company concluded a bitstream access agreement ("BSA") with Telekomunikacja Polska S.A. ("TP SA") and commercially launched its broadband Internet access services over TP SA's network in January 2007. During the third quarter of 2007 the Company began offering Netia voice services to TP SA customers including the arrangement whereby the customer pays a monthly fee to Netia as well as the hitherto call by call charges. Netia pays a line rental fee to TP SA under the Wholesale Line Rental (WLR) administrative decision issued by the telecommunications regulator (Urząd Komunikacji Elektronicznej, "UKE"). During 2008 Netia began to install its own equipment in the TP SA network nodes using a form of regulated access called Local Loop Unbundling (LLU) and began connecting customers using this form of regulated access.

In September 2008 the Company acquired Tele2 Polska Sp. z o.o. ("Tele2 Polska", merged with Netia in February 2009), a company providing voice and broadband services Poland-wide on the basis of regulated access to the TP SA network, including call by call, WLR and BSA.

The Netia Group is also expanding the footprint of its own network and broadband customer base by acquiring local fast ethernet operators. Since the beginning of 2007, the Netia Group has acquired 27 such operators with a total of 105,695 (not in thousands) active customers. Additionally, the Netia Group has acquired 7,810 (not in thousands) customers and local access networks from other Ethernet operators.

To further broaden Netia's product offer, including convergent services, Netia started offering mobile services in September 2008. Netia provides its mobile service based on a Mobile Service Provider Agreement with P4 Sp. z o.o. ("P4"), enabling Netia to buy mobile services wholesale from P4 and resell them as Netia branded mobile services. In the third quarter of 2009, the scope of this cooperation was expanded to cover mobile broadband services as well as mobile handset based voice and data services.

Netia intends to introduce IPTV services into its offering during 2011 and to gradually upgrade its copper and Ethernet access networks using VDSL and fibre to the building (FTTB) technology to deliver faster broadband. In this regard pilot projects were in progress during early 2011.

The Netia Group is also engaged in the installation and supply of specialized mobile radio communication services (public trunking) in Poland through its subsidiary UNI-Net Poland Sp. z o.o. (established in May 2009 through a corporate separation from UNI-Net Sp. z o.o.).

The Company's ordinary shares have been listed on the Warsaw Stock Exchange ("WSE") since July 2000. The Company's shares are currently a component of the mWIG40 index comprising companies of medium capitalization. The Company is subject to periodic reporting requirements under the Polish regulations regarding reporting for companies listed on the WSE.

***Going concern***

As at March 31, 2011, the Group's equity amounted to PLN 2,274,897 and the Netia Group had working capital of PLN 359,068 inclusive of cash available of PLN 210,439 and PLN 175,000 in nominal value of treasury notes. Furthermore, Netia's operations were free cash flow generative in 2010 and the first quarter of 2011 and Management expects this to continue over the medium term. Based on this position, the Management does not believe that events or conditions presently exist which may cast significant doubt on the Company's ability to continue as a going concern.

## 2. Summary of significant accounting policies

***Basis of preparation***

Following European Union regulations, commencing January 1, 2005 Netia as a public company in Poland prepares consolidated financial statements, as required by the Accounting Act of September 29, 1994 (Journal of Laws of 2009, No. 152, item 1,223 with later amendments, "the Accounting Act") in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"). As of May 4, 2011, in light of the current process of IFRS endorsement in the EU and the nature of the Netia Group's activities, there is no difference between IFRS applied by the Netia Group and IFRS endorsed by the EU.

*(All amounts in thousands, except as otherwise stated)*

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" ("IAS 34"). The accounting policies used in the preparation of the interim condensed consolidated financial statements are consistent with those used in the annual consolidated financial statements for the year ended December 31, 2010, except for new accounting standards adopted as of January 1, 2011. These interim condensed consolidated financial statements do not include all the information and disclosures required in complete sets of financial statements and should be read in conjunction with the audited December 31, 2010 consolidated financial statements and the related notes.

Certain Group entities (acquired in 2009, 2010 and 2011) keep books of accounts in accordance with accounting policies specified in the Accounting Act and regulations issued based on that Act ("Polish Accounting Standards"). The consolidated financial statements include a number of adjustments not included in the books of account of the Group entities, which were made in order to bring the financial statements of those entities into conformity with IFRS.

Items included in the financial statements of each of the Netia Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Polish Złoty ("PLN"), which is the Company's functional and presentation currency.

All Euro amounts shown as supplementary information in the consolidated financial statements have been translated from PLN only as a matter of arithmetic computation using the official rate of the National Bank of Poland at March 31, 2011 of PLN 4.0119 to EUR 1.00. These amounts are included for the convenience of the reader only. Such translation should not be construed as a representation that the PLN amounts have been or could be converted into Euros at this or any other rate.

The consolidated financial statements are prepared under the historic cost convention as modified by the revaluation of available-for-sale financial assets and financial assets and financial liabilities at fair value through profit and loss. However, until December 31, 1996, Poland was considered to be a hyperinflationary economy. The consolidated financial statements for the periods through that date were prepared under the historical cost convention as adjusted for the effects of inflation in accordance with IAS 29, "Financial Reporting in Hyperinflationary Economies". The inflated values in PLN at December 31, 1996 for balance sheet items became the new historical basis for subsequent periods.

The preparation of financial statements in conformity with IFRS as adopted by the EU requires the use of certain critical accounting estimates. The areas where assumptions and estimates are significant to the interim condensed consolidated financial statements include property, plant and equipment (estimation of the recoverable amount and economic useful lives), customer relationships (estimation of future economic benefits) and deferred income tax (estimation of future taxable profits).

Costs that arise unevenly during the financial year are anticipated or deferred in the interim consolidated financial statements only if it would be also appropriate to anticipate or defer such costs at the end of the financial year.

Neither the Company's nor the Netia Group's activities are subject to any significant seasonal or cyclical trends of operations.

***Changes in estimates***

In the three-month period ended March 31, 2011 the Netia Group reassessed the useful lives of its fixed telecommunication network, telecommunications equipment and machinery and equipment and in consequence, for certain non-current assets the remaining period over which they will be depreciated was extended (in most cases) and depreciation rates were changed accordingly.

The following table summarizes main changes in these estimates:

| Non-current assets | Main changes in the period of depreciation / amortization | Decrease in the depreciation charge recognized in current period | Relevant increase in the depreciation charge for the remaining useful life |
|---|---|---|---|
| | | (PLN) | (PLN) |
| Fixed telecommunications network | - useful lives of certain assets were changed to 22 years from the date of original capitalisation | (8,751) | 8,751 |
| Fixed telecommunications network | - useful lives of certain assets were extended until the end of 2012 | (82) | 82 |
| Telecommunications equipment | - useful lives of certain assets were extended until the end of 2012 | (3,224) | 3,224 |
| Machinery and equipment | - useful lives of certain assets were extended until the end of 2012 | (213) | 213 |
| **Total impact** | | **(12,270)** | **12,270** |

***New standards, interpretations and amendments to existing standards***

*Adoption of new accounting standards and interpretations*

In 2011, the Netia Group adopted the following new standards, amendments to standards and new interpretations:

- Amendment to IAS 32 "Financial Instruments: Presentation. Classification of Rights Issues" applicable for annual periods beginning on or after February 1, 2010. The amended standard clarifies the classification of rights issues;

- Revised IAS 24 "Related Party Disclosures" applicable for annual periods beginning on or after January 1, 2011. The revised standard simplifies the definition of a related party, clarifies its intended meaning and eliminates inconsistencies from the definition.

- IFRIC 19, "Extinguishing Financial Liabilities with Equity Instruments", effective for annual periods beginning on or after July 1, 2010. This Interpretation addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability.

- Amendments to IFRIC 14 "Prepayments of a Minimum Funding Requirement", effective for annual periods ending on or after January 1, 2011. The amendments apply in limited circumstances: when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements. The amendments permit such an entity to treat the benefit of such an early payment as an asset.

- Amendment to IFRS 1 "Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters" , effective for annual periods beginning on or after July 1, 2010. The amendment applies the same transition provisions for first-time adopters as for existing preparers of financial statements included in Amendments to IFRS 7 "Improving Disclosures about Financial Instruments";

- Amendments to IFRS resulting from the annual improvements project, issued in May 2010 and effective for annual periods beginning the earliest on or after July 1, 2010, depending on which IFRS the amendment relates to.

Adoption of other amendments and interpretations listed above did not have any effect on the financial position of the Netia Group's operations.

*Standards, interpretations and amendments to published standards that are not yet effective*

The following new standards, amendments to standards and interpretations have been issued but are not effective for 2011 and have not been adopted early:

- IFRS 9 "Financial Instruments" applicable for annual periods beginning on or after January 1, 2013. IFRS 9 is the first part of Phase 1 of the Board's project to replace IAS 39. IFRS 9 improves and simplifies the approach for classification and measurement of financial assets compared with the requirements of IAS 39. This standard has not yet been endorsed by the EU;

- Amendments to IFRS 7 "Disclosures - Transfers of Financial Assets". Amendments to the IFRS are to help users of financial statements evaluate the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position and will promote transparency in the reporting of transfer transactions, particularly those that involve securitisation of financial assets. Entities are required to apply the amendments for annual periods beginning on or after 1 July 2011. The amendments have not yet been endorsed by the EU.

- Amendments to IAS 12 Income Tax: Deferred Tax: Recovery of Underlying Assets, effective for financial years beginning on or after 1 January 2012. The amendments have not yet been endorsed by the EU.

- Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards: Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters, effective for financial years beginning on or after 1 July 2011. The amendments have not yet been endorsed by the EU.

Management is currently assessing the impact of the above standards and interpretations on the Netia Group's operations.

## 3. Segment information

For management purposes, the Netia Group is organized into business units based on their customer segments, and has four reportable operating segments, as follows:

- Home, i.e. residential clients,
- SOHO / SME, i.e. small and medium enterprises,
- Corporate, i.e. large enterprises,
- Carriers, i.e. other telecom service providers.

Management monitors the operating results of its customer segments separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on EBITDA (defined as operating profit / (loss) excluding depreciation and amortization) and Adjusted EBITDA (defined as operating profit / (loss) excluding depreciation and amortization as well as significant one-off transactions) which is derived from the information in the consolidated financial statements. The Netia Group financing (including finance costs and finance income) and income taxes are managed on a group basis and are not allocated to operating segments. As Netia considers its network to be a single cash generating unit, non-current assets are not acquired by individual operating segments, but shared between them. In order to produce operating profit ("EBIT") for each segment, depreciation and amortization from the shared assets also has to be allocated. The Company uses expected future cash flows from each segment as a basis to allocate assets, depreciation and amortization. The resulting allocations can be volatile between periods, but unlike EBITDA, Management does not place reliance on these segment EBIT results for decision making purposes. Following a management change from January 1, 2011, responsibility for servicing local Internet providers was moved from the Corporate segment to the Carrier segment. Comparative information has been adjusted accordingly to reflect this reclassification.

*(All amounts in thousands, except as otherwise stated)*

No operating segments have been aggregated to form these reportable operating segments.

The following tables present revenue and profit / (loss) information regarding the Netia Group's operating segments for the three-month periods ended March 31, 2011 and 2010, respectively:

| | Home | SOHO / SME | Corporate | Carriers | Total reportable segments | Unallocated | Total |
|---|---|---|---|---|---|---|---|
| | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) |
| **Three-month period ended March 31, 2011** | | | | | | | |
| **Revenue from external customers** | **207,820** | **49,163** | **85,455** | **57,128** | **399,566** | **1,623** | **401,189** |
| **Adjusted EBITDA** | **39,829** | **16,517** | **46,141** | **26,970** | **129,457** | **(27,953)** | **101,504** |
| Expenses incurred on mergers and acqusitions | - | - | - | - | - | (129) | (129) |
| **EBITDA** | **39,829** | **16,517** | **46,141** | **26,970** | **129,457** | **(28,082)** | **101,375** |
| Depreciation and Amortization | (16,613) | (12,385) | (25,209) | (13,119) | (67,326) | (7,999) | (75,325) |
| Operating profit / (loss) | 23,216 | 4,132 | 20,932 | 13,851 | 62,131 | (36,081) | 26,050 |
| Finance income, net | - | - | - | - | - | 3,060 | 3,060 |
| Income tax charge | - | - | - | - | - | (52,155) | (52,155) |
| **Profit / (Loss)** | **23,216** | **4,132** | **20,932** | **13,851** | **62,131** | **(85,176)** | **(23,045)** |
| Capital expenditure | 16,250 | 3,352 | 12,774 | 4,631 | 37,007 | 3,913 | 40,920 |

| | Home | SOHO / SME | Corporate | Carriers | Total reportable segments | Unallocated | Total |
|---|---|---|---|---|---|---|---|
| | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) |
| **Three-month period ended March 31, 2010** | | | | | | | |
| **Revenue from external customers** | **205,546** | **44,450** | **83,853** | **51,583** | **385,432** | **1,547** | **386,979** |
| **Adjusted EBITDA** | **33,283** | **13,559** | **46,011** | **26,617** | **119,470** | **(28,664)** | **90,806** |
| Restructuring cost | | | | | | (137) | (137) |
| Profit on sale of P4 Transmission assets | - | - | - | 2,865 | 2,865 | - | 2,865 |
| **EBITDA** | **33,283** | **13,559** | **46,011** | **29,482** | **122,335** | **(28,801)** | **93,534** |
| Depreciation and Amortization | (18,102) | (12,516) | (23,956) | (10,792) | (65,366) | (8,606) | (73,972) |
| Operating profit / (loss) | 15,181 | 1,043 | 22,055 | 18,690 | 56,969 | (37,407) | 19,562 |
| Finance cost, net | - | - | - | - | - | (2,129) | (2,129) |
| Income tax charge | - | - | - | - | - | (3,081) | (3,081) |
| **Profit / (Loss)** | **15,181** | **1,043** | **22,055** | **18,690** | **56,969** | **(42,625)** | **14,352** |
| Capital expenditure | 9,352 | 2,596 | 10,769 | 3,369 | 26,086 | 2,942 | 29,029 |

Unallocated revenues comprise mainly revenues from the radio communication segment. A reconciliation of earnings before interest and tax ("EBIT") for reportable segments to profit / (loss) is provided as follows:

| | Three-month period ended March 31, 2011 | Three-month period ended March 31, 2010 |
|---|---|---|
| | (PLN) | (PLN) |
| EBIT for reportable segments | 62,131 | 56,969 |
| Radio communication segment | (15) | 84 |
| General fixed costs (incl. administration, IT, professional services) | (30,659) | (27,305) |
| Reorganization and restructuring costs | - | (138) |
| Other operating income/ (expenses) | 2,508 | (1,534) |
| Depreciation and amortization of unallocated assets (excluding radio communication segment) | (7,915) | (8,514) |
| Finance income / (cost), net | 3,060 | (2,129) |
| Income tax charge | (52,155) | (3,081) |
| Profit / (Loss) | (23,045) | 14,352 |

The Netia Group operates in one geographical area, which is the territory of Poland.

## 4. Significant one-off transactions recorded in the current interim period

***Tax decision (not in thousands)***

In February 2010 the Director of the Tax Chamber in Warsaw ("Tax Chamber Director") issued a decision ("Decision") according to which Netia's corporate income tax due for the year 2003 was set at PLN 34.2 million plus penalty interest of approximately PLN 25.3 million. The decision closed proceedings related to Netia's appeal of a decision of the Director of the Tax Control Office in Warsaw ("UKS Director") according to which Netia's corporate income tax due for the year 2003 was originally set at PLN 58.7 million plus penalty interest amounting to PLN 41.3 million.

The decision of the Tax Chamber Director was issued despite legal arguments presented by the Company, which claimed that the conclusions delivered by the Tax Control Office were incorrect and groundless. According to the Tax Chamber Director and the UKS Director, Netia understated its taxable income by PLN 247.5 million by excluding from its revenues the accrued and not received interest from loans granted by Netia in earlier years to subsidiaries which subsequently merged with Netia on December 31, 2003. The Director of UKS, as the first instance tax authority, claimed in its earlier decision that Netia understated its taxable income by PLN 303 million.

The Tax Chamber Director's decision, which partially upheld the decision of the UKS Director, was enforceable as a decision of the second instance tax authority. The liability of PLN 59.6 million was settled in February 2010, from which PLN 1.3 million was returned by the tax office to Netia.

Netia received opinions from several independent tax and legal advisors, as well as tax law experts, which concluded that the claims of the Directors of the Tax Control Office and the Tax Chamber have no legal grounds. Accordingly, following the payment of the PLN 58.3 million and having recourse to two levels of independent civil court in which to obtain a positive ruling, Management took the position during 2010 that recovery through the courts is virtually certain and did not recognize the Tax Chamber's decision as a taxation expense for the financial year ended December 31, 2010 and instead treated funds paid over to the tax authorities as an overpayment of tax.

However, having heard Netia's appeal of the decision of the Tax Chamber Director, on 15 March 2011 the Voivodship Administrative Court ("WSA") in Warsaw announced a judgment with respect to the Decision and the Court dismissed the Company's claim in its entirety. Management is still waiting to receive the written justification of this decision as at the date of these financial statements.

Following the WSA decision in favour of the tax office, Management recognizes that there is now only one instance remaining to obtain a favourable ruling and the existence of strong tax opinions is no longer sufficient to maintain the judgment that recovery is virtually certain.

Consequently, in the first quarter of the year 2011 the Company recognized the taxes and related penalty interest already paid in 2010 as an income tax expense relating to the year 2003 of PLN 58,325 thousands.

The Voivodship Administrative Court's judgment is not final. The Company intends to file a cassation claim to the Supreme Administrative Court.

*(All amounts in thousands, except as otherwise stated)*

## 5. Property, plant and equipment

*Current period:*

| | Buildings (PLN) | Land (PLN) | Fixed telecommunications network (PLN) | Telecommunications equipment (PLN) | Machinery and equipment (PLN) | Office furniture and equipment (PLN) | Vehicles (PLN) | Fixed assets under construction (PLN) | Total (PLN) |
|---|---|---|---|---|---|---|---|---|---|
| Gross book value as at January 1, 2011 | 63,788 | 4,979 | 2,076,941 | 1,965,036 | 115,102 | 72,620 | 1,578 | 83,256 | 4,383,300 |
| Additions | - | - | 115 | 48 | 10 | 184 | - | 36,205 | 36,562 |
| Transfer from investment property | 26,500 | - | - | - | - | - | - | - | 26,500 |
| Purchase of subsidiary | - | - | 101 | - | - | - | - | - | 101 |
| Transfers | 46 | - | 9,566 | 13,823 | 1,256 | 162 | - | (24,853) | - |
| Disposals | - | - | - | (337) | (68) | (918) | (84) | (51) | (1,458) |
| Other movements | - | - | (134) | 221 | (91) | 4 | - | - | - |
| **Gross book value as at March 31, 2011** | 90,334 | 4,979 | 2,086,589 | 1,978,791 | 116,209 | 72,052 | 1,494 | 94,557 | 4,445,005 |
| Accumulated depreciation as at January 1, 2011 | 23,686 | - | 868,326 | 1,040,579 | 69,602 | 54,902 | 910 | - | 2,058,005 |
| Depreciation expense | 1,212 | - | 14,984 | 37,039 | 1,786 | 1,731 | 72 | - | 56,824 |
| Transfer from investment property | 5,417 | - | - | - | - | - | - | - | 5,417 |
| Disposals | - | - | (5) | (217) | (59) | (757) | (60) | - | (1,098) |
| Other movements | - | - | (89) | 229 | (145) | 5 | - | - | - |
| **Accumulated depreciation as at March 31, 2011** | 30,315 | - | 883,216 | 1,077,630 | 71,184 | 55,881 | 922 | - | 2,119,148 |
| Accumulated impairment as at January 1, 2011 | 6,491 | 534 | 510,546 | 308,801 | 15,878 | 5,312 | 18 | 2,033 | 849,613 |
| Impairment charge for specific assets | - | - | - | - | - | 67 | - | 891 | 958 |
| Transfer from investment property | 1,844 | - | - | - | - | - | - | - | 1,844 |
| Transfers | - | - | - | 2 | - | - | - | (2) | - |
| Disposals | - | - | - | (65) | - | (158) | - | - | (223) |
| Other movements | - | - | (11) | (25) | 36 | - | - | - | - |
| **Accumulated impairment as at March 31, 2011** | 8,335 | 534 | 510,535 | 308,713 | 15,914 | 5,221 | 18 | 2,922 | 852,192 |
| Net book value as at January 1, 2011 | 33,611 | 4,445 | 698,069 | 615,656 | 29,622 | 12,406 | 650 | 81,223 | 1,475,682 |
| **Net book value as at March 31, 2011** | **51,684** | **4,445** | **692,838** | **592,448** | **29,111** | **10,950** | **554** | **91,635** | **1,473,665** |

*(All amounts in thousands, except as otherwise stated)*

## 5. Property, plant and equipment (cont'd)

*Comparative period:*

| | Buildings (PLN) | Land (PLN) | Fixed telecommunications network (PLN) | Telecommunications equipment (PLN) | Machinery and equipment (PLN) | Office furniture and equipment (PLN) | Vehicles (PLN) | Fixed assets under construction (PLN) | Total (PLN) |
|---|---|---|---|---|---|---|---|---|---|
| Gross book value as at January 1, 2010 | 45,526 | 5,127 | 2,026,040 | 1,895,760 | 110,263 | 123,778 | 5,993 | 107,791 | 4,320,278 |
| Additions | 204 | - | 80 | 166 | 72 | 201 | 172 | 25,669 | 26,564 |
| Purchase of operational networks | - | - | 340 | 45 | - | 7 | - | - | 392 |
| Transfers | 2,466 | - | 12,528 | 27,429 | 1,294 | 344 | - | (44,061) | - |
| Disposals | - | (115) | (53) | (21,977) | (142) | (2,312) | (2,973) | (102) | (27,674) |
| Other movements | (7) | - | 496 | (936) | 458 | (135) | - | - | (124) |
| **Gross book value as at March 31, 2010** | 48,189 | 5,012 | 2,039,431 | 1,900,487 | 111,945 | 121,883 | 3,192 | 89,297 | 4,319,436 |
| Accumulated depreciation as at January 1, 2010 | 20,203 | - | 794,051 | 910,493 | 64,420 | 100,844 | 3,668 | - | 1,893,679 |
| Depreciation expense | 810 | - | 18,291 | 34,213 | 1,658 | 1,485 | 201 | - | 56,658 |
| Disposals | - | - | (18) | (3,782) | (95) | (2,179) | (1,978) | - | (8,052) |
| Other movements | (1) | - | 69 | (430) | 425 | (63) | - | - | - |
| **Accumulated depreciation as at March 31, 2010** | 21,012 | - | 812,393 | 940,494 | 66,408 | 100,087 | 1,891 | - | 1,942,285 |
| Accumulated impairment as at January 1, 2010 | 7,341 | 1,125 | 631,419 | 368,640 | 18,404 | 10,133 | 30 | 2,780 | 1,039,872 |
| Impairment charge for specific assets | | | | | | | | | |
| Transfers | - | - | 16 | 170 | 20 | - | - | (206) | - |
| Disposals | - | (46) | (17) | (4) | (7) | (133) | (9) | (60) | (276) |
| Other movements | - | - | 22 | (152) | 191 | (61) | - | - | - |
| **Accumulated impairment as at March 31, 2010** | 7,341 | 1,079 | 631,440 | 368,654 | 18,608 | 9,939 | 21 | 2,514 | 1,039,596 |
| Net book value as at January 1, 2010 | 17,982 | 4,002 | 600,570 | 616,627 | 27,439 | 12,801 | 2,295 | 105,011 | 1,386,727 |
| **Net book value as at March 31, 2010** | **19,836** | **3,933** | **595,598** | **591,339** | **26,929** | **11,857** | **1,280** | **86,783** | **1,337,555** |

(All amounts in thousands, except as otherwise stated)

## 6. Acquisitions

*Current period*

***Acquisition of Ethernet operators***

***Netpro Sp. z o.o.***

On March 30, 2011, Internetia Sp. z o.o. ("Internetia"), the Company's subsidiary, purchased 100% of the share capital of Netpro Sp. z o.o. ("Netpro"), an internet service provider offering broadband Internet access to residential clients. The total price for all Netpro shares has been set at PLN 600.

The Netia Group accounted for the acquisition of Netpro using the purchase method and started consolidating the financial statements of Netpro as of March 31, 2011.

If the acquisition had occurred on January 1, 2011, the Netia Group's revenue would have amounted to PLN 401,280 and loss would have been PLN 23,031.

The Netia Group performed a valuation of the acquired company's assets, liabilities and contingent liabilities. In the purchase price allocation process the Netia Group identified customer relationships as an intangible asset. The fair value of customer relationships was estimated using the excess earnings method. Further changes to the valuation may be introduced during the course of 12 months from the acquisition dates if additional information in respect of acquired assets, liabilities and contingent liabilities is obtained. Such additional information may include information related to pre-acquisition contingencies and calculation of the related deferred income taxes. The Netia Group will continue evaluating fair values of these assets, liabilities and contingent liabilities, which may result in further adjustments to the carrying amounts of identifiable net assets.

Details of provisional fair values of net assets acquired and goodwill as of the date of the acquisition are as follows:

| | (PLN) |
|---|---|
| Purchase consideration | 600 |
| Provisional fair value of net assets acquired | (249) |
| Goodwill | **351** |

The goodwill is based on provisional fair values of net assets acquired and is attributable to the significant synergies expected to arise after the Netia Group's acquisition. None of the recognized goodwill is expected to be deductible for income tax purposes.

The assets and liabilities recognized in the consolidated statement of financial position arising from the acquisition, as at the acquisition date, are as follows:

| | Acquiree's carrying amount (PLN) | Provisional fair value (PLN) |
|---|---|---|
| Customer relationships | - | 165 |
| Property, plant and equipment | 101 | 101 |
| Intangible assets | 7 | 7 |
| Trade receivables | 9 | 9 |
| Inventory | 4 | 4 |
| Cash and cash equivalents | 27 | 27 |
| Trade liabilities | (10) | (10) |
| Tax and other liabilities | (23) | (23) |
| Deferred income tax, net | - | (31) |
| Net assets acquired | **115** | **249** |

Fair value of the purchase consideration transferred for the acquisition:

| | (PLN) |
|---|---|
| Cash paid | 600 |
| Total consideration | **600** |

| | (PLN) |
|---|---|
| Total purchase consideration settled in cash | (600) |
| Cash and cash equivalents in the subsidiary acquired | 27 |
| Cash outflow on acquisition | **(573)** |

The above investments are of a long-term nature.

Comparative period

***Operational networks***

During the first quarter of 2010 the Netia Group purchased networks and customers from Ethernet operators for a total price of PLN 818. Fair values of the acquired fixed assets and customer relationships were estimated at PLN 394 and PLN 390, respectively. Total cash outflow relating to these acquisitions amounted to PLN 818. The goodwill of PLN 34 that arose on these transactions is based on the fair value of net assets acquired and is attributable to the synergies expected to arise after the Netia Group's acquisition of the above networks.

*(All amounts in thousands, except as otherwise stated)*

## 7. Intangible assets

*Current period:*

| | Goodwill | Trademark/ know how | Licences: Local telecommunication licenses / permits | Licences: Data communications and internet licenses / permits | Licences: Domestic long-distance licenses / permits | Licences: WiMAX licenses | Computer software costs: Computer software | Computer software costs: Capital work in progress | Customer relationships | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) | (PLN) |
| Gross book value as at January 1, 2011 | 159,446 | 2,970 | 432,823 | 7,417 | 107,354 | 20,329 | 339,672 | 11,333 | 85,269 | 1,166,613 |
| Additions | - | - | - | - | - | - | - | 4,358 | - | 4,358 |
| Purchase of subsidiary | 351 | 7 | - | - | - | - | - | - | 165 | 523 |
| Transfers | - | - | - | - | - | - | 9,196 | (9,196) | - | - |
| **Gross book value as at March 31, 2011** | 159,797 | 2,977 | 432,823 | 7,417 | 107,354 | 20,329 | 348,868 | 6,495 | 85,434 | 1,171,494 |
| Accumulated amortization as at January 1, 2011 | - | 2,970 | 222,952 | 1,539 | 55,952 | 5,227 | 224,625 | - | 48,562 | 561,827 |
| Amortization expense | - | - | 4,800 | - | 1,350 | 352 | 7,256 | - | 4,465 | 18,223 |
| **Accumulated amortization as at March 31, 2011** | - | 2,970 | 227,752 | 1,539 | 57,302 | 5,579 | 231,881 | - | 53,027 | 580,050 |
| Accumulated impairment as at January 1, 2011 | - | - | 143,739 | 5,878 | 21,547 | 974 | 42,620 | 385 | 199 | 215,342 |
| **Accumulated impairment as at March 31, 2011** | - | - | 143,739 | 5,878 | 21,547 | 974 | 42,620 | 385 | 199 | 215,342 |
| Net book value as at January 1, 2011 | 159,446 | - | 66,132 | - | 29,855 | 14,128 | 72,427 | 10,948 | 36,508 | 389,444 |
| **Net book value as at March 31, 2011** | **159,797** | **7** | **61,332** | **-** | **28,505** | **13,776** | **74,367** | **6,110** | **32,208** | **376,102** |

*(All amounts in thousands, except as otherwise stated)*

## 7. Intangible assets (cont'd)

*Comparative period:*

| | | | **Licences** | | | | **Computer software costs** | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Goodwill** | **Trademark** | **Local telecommunication licenses / permits** | **Data communications and internet licenses / permits** | **Domestic long-distance licenses / permits** | **WiMAX licenses** | **Computer software** | **Capital work in progress** | **Customer relationships** | **Total** |
| | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** | **(PLN)** |
| Gross book value as at January 1, 2010 | 150,178 | 2,970 | 432,823 | 7,417 | 107,354 | 20,329 | 317,073 | 6,382 | 80,344 | 1,124,870 |
| Additions | - | - | - | - | - | - | 239 | 2,226 | - | 2,465 |
| Purchase of operational networks | 34 | - | - | - | - | - | - | - | 390 | 424 |
| Transfers | - | - | - | - | - | - | 4,533 | (4,533) | - | - |
| Disposals | - | - | - | - | - | - | (19) | - | - | (19) |
| Other movements | - | - | - | - | - | - | 126 | - | - | 126 |
| **Gross book value as at March 31, 2010** | 150,212 | 2,970 | 432,823 | 7,417 | 107,354 | 20,329 | 321,952 | 4,075 | 80,734 | 1,127,866 |
| Accumulated amortization as at January 1, 2010 | - | 2,970 | 208,456 | 1,539 | 51,865 | 4,057 | 193,487 | - | 31,510 | 493,884 |
| Amortization expense | - | - | 3,625 | - | 1,022 | 292 | 7,901 | - | 4,204 | 17,044 |
| Disposals | - | - | - | - | - | - | (14) | - | - | (14) |
| Other movements | - | - | - | - | - | - | 74 | - | - | 74 |
| **Accumulated amortization as at March 31, 2010** | - | 2,970 | 212,081 | 1,539 | 52,887 | 4,349 | 201,448 | - | 35,714 | 510,988 |
| Accumulated impairment as at January 1, 2010 | - | - | 159,788 | 5,878 | 28,511 | 3,408 | 43,998 | 385 | 207 | 242,175 |
| Transfers | - | - | - | - | - | - | - | - | - | - |
| Other movements | - | - | - | - | - | - | 29 | - | - | 29 |
| **Accumulated impairment as at March 31, 2010** | - | - | 159,788 | 5,878 | 28,511 | 3,408 | 44,027 | 385 | 207 | 242,204 |
| | | | | | | | | - | | |
| Net book value as at January 1, 2010 | 150,178 | - | 64,579 | - | 26,978 | 12,864 | 79,588 | 5,997 | 48,627 | 388,811 |
| **Net book value as at March 31, 2010** | **150,212** | **-** | **60,954** | **-** | **25,956** | **12,572** | **76,477** | **3,690** | **44,813** | **374,674** |

(All amounts in thousands, except as otherwise stated)

## 8. Investment property

| | Three-month period ended March 31, 2011 | Three-month period ended March 31, 2010 |
|---|---|---|
| | (PLN) | (PLN) |
| Gross book value at the beginning of the period | 60,768 | 59,952 |
| Additions | 366 | 181 |
| Transfer to property, plant and equipment | (26,500) | - |
| **Gross book value at the end of the period** | 34,634 | 60,133 |
| Accumulated depreciation at the beginning of the period | (12,123) | (11,316) |
| Depreciation expense | (278) | (216) |
| Transfer to property, plant and equipment | 5,417 | - |
| **Accumulated depreciation at the end of the period** | (6,984) | (11,532) |
| Accumulated impairment at the beginning of the period | (3,561) | (13,062) |
| Reversal of impairment charge | - | (1) |
| Transfer to property, plant and equipment | 1,844 | - |
| **Accumulated impairment at the end of the period** | (1,717) | (13,063) |
| Net book value at the beginning of the period | **45,084** | **35,574** |
| **Net book value at the end of the period** | **25,933** | **35,538** |

Management decided to cease marketing one of three buildings comprising the Company's former head office for a potential sale and leaseback transaction and therefore reclassified this building from investment property to property, plant and equipment as at March 31, 2011. This reclassified building houses network equipment crucial for the operation of Netia's network. The remaining buildings and land classified as investment property are surplus to the Company's requirements. The investment property is currently rented to third party tenants and is being marketed for sale or joint redevelopment.

## 9. Financial instruments

***Forward contracts***

In order to mitigate the currency risk related to the planned payments to be made under equipment and construction contracts which are linked to foreign currencies the Company entered into several forward transactions to purchase USD and EUR for periods consistent with currency transaction exposures, generally up to 12 months. For these forward contracts hedge accounting was applied. Net fair value losses on forward contracts recognized in the hedging reserve in equity on these contracts as of March 31, 2011 amounted to PLN 240 (PLN 199, net of tax). During the three-month period ended March 31, 2011, PLN 125 of net cash losses on closed forward contracts were capitalized and the ineffective portion of open forward contracts of PLN 7 was recorded as finance costs..

Furthermore, in order to mitigate the currency risk related to the planned payments to be made under commercial contracts associated with various types of operating expense which are linked to foreign currency, the Company entered into several forward transactions to purchase USD and EUR for periods consistent with currency transaction exposures, generally up to 12 months. For these forward contracts hedge accounting was not applied. During the three-month period ended March 31, 2011, PLN 22 of fair value gains on open forward contracts were recorded as finance income.

The table below presents outstanding forward transactions as at balance sheet date:

| | Hedged nominal amount | Hedged nominal amount | Fair value | | |
|---|---|---|---|---|---|
| | | | Asset | Liability | Other comprehensive income |
| | (EUR) | (USD) | (PLN) | (PLN) | (PLN) |
| As at March 31, 2011 | | | | | |
| Forward transactions related to equipment and construction contracts | 2,550 | 2,440 | 53 | (601) | (240) |
| Forward transactions related to commercial contracts | 3,780 | 1,180 | 64 | (443) | - |
| As at March 31, 2010 | | | | | |
| Forward transactions related to equipment and construction contracts | 4,960 | 3,100 | 41 | (2,301) | (451) |
| Forward transactions related to commercial contracts | 6,480 | 1,400 | 22 | (2,152) | - |
| As at December 31, 2010 | | | | | |
| Forward transactions related to equipment and construction contracts | 2,700 | 2,380 | 77 | (408) | 2,060 |
| Forward transactions related to commercial contracts | 4,380 | 1,330 | 40 | (441) | - |

***Held to maturity investments***

| | | March 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|---|
| | Maturity date | Nominal value | Carrying amount | Nominal value | Carrying amount |
| | | (PLN) | (PLN) | (PLN) | (PLN) |
| 52-week treasury notes | March 16, 2011 | - | - | 10,000 | 9,922 |
| 52-week treasury notes | March 16, 2011 | - | - | 10,000 | 9,921 |
| 52-week treasury notes | March 23, 2011 | - | - | 10,000 | 9,914 |
| 52-week treasury notes | March 23, 2011 | - | - | 10,000 | 9,914 |
| 52-week treasury notes | April 27, 2011 | 10,000 | 9,972 | 10,000 | 9,879 |
| 52-week treasury notes | June 1, 2011 | 10,000 | 9,935 | 10,000 | 9,842 |
| 52-week treasury notes | June 8, 2011 | 10,000 | 9,928 | 10,000 | 9,834 |
| 52-week treasury notes | June 15, 2011 | 10,000 | 9,919 | 10,000 | 9,823 |
| 52-week treasury notes | July 6, 2011 | 10,000 | 9,893 | 10,000 | 9,794 |
| 52-week treasury notes | August 10, 2011 | 10,000 | 9,859 | 10,000 | 9,764 |
| 52-week treasury notes | August 10, 2011 | 10,000 | 9,858 | 10,000 | 9,763 |
| 52-week treasury notes | August 10, 2011 | 10,000 | 9,859 | 10,000 | 9,765 |
| 52-week treasury notes | August 10, 2011 | 10,000 | 9,858 | 10,000 | 9,762 |
| 52-week treasury notes | August 31, 2011 | 10,000 | 9,837 | 10,000 | 9,743 |
| 52-week treasury notes | September 28, 2011 | 10,000 | 9,810 | 10,000 | 9,716 |
| 52-week treasury notes | September 28, 2011 | 15,000 | 14,718 | 15,000 | 14,580 |
| 52-week treasury notes | October 26, 2011 | 10,000 | 9,776 | 10,000 | 9,680 |
| 52-week treasury notes | February 29, 2012 | 10,000 | 9,602 | - | - |
| 52-week treasury notes | February 29, 2012 | 10,000 | 9,601 | - | - |
| 52-week treasury notes | February 29, 2012 | 10,000 | 9,603 | - | - |
| 52-week treasury notes | March 28, 2012 | 10,000 | 9,572 | - | - |
| | | **175,000** | **171,600** | **175,000** | **171,616** |

## 10. Shareholders' equity

***Share capital (not in thousands)***

At December 31, 2010, the Company's share capital consisted of 389,458,229 ordinary shares and 1,000 series A1 shares with a par value of PLN 1 per share. Each ordinary share has one vote at the shareholders' meeting. The holder of 1,000 series A1 shares has the right to nominate one member of the Supervisory Board. The majority of votes of the Supervisory Board elect the Management Board.

In the three-month period ended March 31, 2011 the Company issued 915,381 ordinary series K shares due to two Management Board members and certain persons who were not Management Board members exercising their rights arising from the key employee share option plan adopted by Netia's Supervisory Board in 2003 (the "2003 Plan"). The total number of options exercised in the three-month period ended March 31, 2011 was 4,710,622, from which 2,709,250 exercised options related to the 915,381ordinary series K shares issued in the three-month period ended March 31, 2011 and 2,001,372 exercised options related to 668,358 ordinary series K shares issued on April 6, 2011 (see Note 21).

The 5,115,579 series K shares issued prior to Netia's General Meeting of Shareholders held on May 26, 2010, including 61,059 shares issued in 2010, were redesignated, in accordance with a resolution adopted by Netia's General Meeting of Shareholders, as series B shares. Following this change of the Company's Statute in 2010 up to 13,258,206 series K shares may be issued. The total number of series K shares issued through March 31, 2011 was 1,036,257 and their nominal value was PLN 1,036,257.

On May 26, 2010, the Annual Shareholders Meeting resolved to authorize the issuance of up to 13,626,832 series L shares to meet obligations that may arise from execution of share options to be issued under a new stock option plan ("New Plan").

As a result at March 31, 2011, the Company's share capital consisted of 390,373,610 ordinary shares and 1,000 series A1 shares with a par value of PLN 1 per share. Each share had one vote at shareholders' meetings.

***Distributable reserves***

In accordance with the Polish Code of Commercial Companies of 15 September 2000 (Journal of Laws of 2000, No. 94, item 1037 as amended) only those reserves, which relate to net profits of individual companies shown in their statutory financial statements, are available for distribution to shareholders. As at March 31, 2011, the distributable reserves of Netia S.A. amounted to PLN 488,821.

***Stock options (not in thousands)***

*2003 Plan*

In the three-month period ended March 31, 2011 and 2010 the following changes took place in the number of options granted under the Plan:

| | **Three-month period ended March 31, 2011** | | **Three-month period ended March 31, 2010** | |
|---|---|---|---|---|
| **Options** | **Average strike price** | **Options** | **Average strike price** | **Options** |
| At the beginning of the period | 5.87 | 53,245,436 | 5.84 | 53,946,373 |
| Exercised | 3.54 | (4,710,622) | 3.50 | (210,000) |
| At the end of the period | **6.10** | **48,534,814** | **5.85** | **53,736,373** |

As at March 31, 2011 and December 31, 2010 the total number of options approved by the Supervisory Board and issued was 87,877,470. Out of these approved options 48,534,814 options were outstanding as at March 31, 2011 and 53,245,436 options were outstanding as at December 31, 2010. As at March 31, 2011 and December 31, 2010 the total number of outstanding vested options was 46,146,564 and 46,788,436, respectively. The vesting period for the options is up to three years from the date of grant. As at March 31, 2011, the weighted average remaining contractual life of the outstanding options was 2 years. The outstanding options are exercisable until December 20, 2012. Upon exercise of the options, Netia will issue to each exercising participant the number of shares representing such participant's gain resulting from the exercise of the options, being the difference between the exercise price of the Company's shares and strike price of the options. The participant will not be required to pay the strike price ranging from PLN 3.50 to PLN 8.25.

The Company recognizes the cost of share-based awards to employees (including share options) over the vesting period and the fair value of options is determined using a binomial pricing model. The cost of options recorded in the three-month periods ended March 31, 2011 and 2010 amounted to PLN 509 thousands and PLN 3,182 thousands, respectively.

*New Plan*

On May 26, 2010, the Annual Shareholders Meeting resolved to adopt a set of rules, to be administered by the Company's Supervisory Board, for the issuing of up to 27,253,674 share options to the Management Board and employees of Netia Group, each option authorising its holder to receive up to half of one series L share for subscription price equal to the nominal valueof the shares in the Company i. e. PLN 1, such subscription price to be paid by the Company or its subsidiaries. The latest exercise date of these share options may be not later than May 26, 2020. In order to satisfy the claims arising from the exercise of the options under New Plan, the Shareholders Meeting resolved to authorize the issuance of up to 13,626,837 series L shares.

In the three-month period ended March 31, 2011 the Supervisory Board granted 1,725,000 options to members of the Management Board and authorized the Management Board to grant a further 2,168,382 options to Netia's Group key employees under the New Plan. On the basis of this authorization, the Management Board granted 1,748,000 options to key employees. As at March 31, 2011, the weighted average remaining contractual life of the outstanding options was 9 years. The outstanding options are exercisable until May 26, 2020. Upon exercise of the options, Netia will issue to each exercising participant the number of shares representing such participant's gain resulting from the exercise of the options, being the difference between the market price of the Company's shares as of the date of exercise of the options and strike price of the options. The participant will not be required to pay the strike price ranging from PLN 5.23 to PLN 5.24. The fair value of these granted options was PLN 6,201 thousand as at the grant date.

The Company recognizes the cost of share-based awards to employees (including share options) over the vesting period and the fair value of options is determined using a binomial pricing model. The cost of options recorded in the three-month periods ended March 31, 2011 amounted to PLN 108 thousands.

| | **Three-month period ended March 31, 2011** | | **Three-month period ended March 31, 2010** | |
|---|---|---|---|---|
| **Options** | **Average strike price** | **Options** | **Average strike price** | **Options** |
| At the beginning of the period | - | - | - | - |
| Granted | 5.24 | 3,473,000 | - | - |
| At the end of the period | **5.24** | **3,473,000** | - | - |

## 11. Borrowings

*Undrawn Borrowing facilities*

On July 29, 2010 Netia signed a mandate letter with Rabobank, Raiffeisen Bank Polska S.A. and BRE Bank S.A. for arrangement of new financing for a potential market consolidating acquisition within the telecommunications sector in Poland.

On October 4, 2010 bank BNP Paribas, Polish branch, (BNP Paribas SA Oddział w Polsce) joined the mandate letter signed by the Company on July 29, 2010 with Rabobank Polska S.A., Raiffeisen Bank Polska S.A. and BRE Bank S.A. (the "Mandate") for arrangement of new financing fund potential acquisitions by Netia.

The total amount of external financing which may be obtained under the Mandate is PLN 700,000.

(All amounts in thousands, except as otherwise stated)

## 12. Other gains / (losses), net

| | Three-month period ended March 31, 2011 (PLN) | Three-month period ended March 31, 2010 (PLN) |
|---|---|---|
| Loss on sale of impaired receivables | (10) | - |
| Gain/ (loss) on disposal of fixed assets | (14) | 3,283 |
| Net foreign exchange gains / (losses) | (287) | (512) |
| | **(311)** | **2,771** |

## 13. Finance income and finance costs

***Finance income***

| | Three-month period ended March 31, 2011 (PLN) | Three-month period ended March 31, 2010 (PLN) |
|---|---|---|
| Interest income on cash and cash equivalents | 1,600 | 1,318 |
| Amortization of held to maturity investments | 1,660 | 659 |
| Fair value gains on open forward contracts hedging commercial exposures ( Note 9) | 22 | - |
| Other finance income | - | 786 |
| | **3,282** | **2,763** |

***Finance costs***

| | Three-month period ended March 31, 2011 (PLN) | Three-month period ended March 31, 2010 (PLN) |
|---|---|---|
| Fees charged on bank loans | - | (2,838) |
| Amortization of finance lease liability | (84) | (115) |
| Interest expense and amortization of other payables | - | (14) |
| Amortization of provisions | (15) | (15) |
| Fair value gain / (loss) on equity securities (Note 9) | - | (881) |
| Net foreign exchange losses | (112) | (661) |
| Excess of the amount of closed forward contracts over purchases made | - | (158) |
| Fair value losses on open forward contracts hedging commercial exposures | - | (215) |
| Ineffective cash flow hedges | (7) | 5 |
| Other finance costs | (4) | - |
| | **(222)** | **(4,892)** |

## 14. Corporate income tax

| | Three-month period ended March 31, 2011 (PLN) | Three-month period ended March 31, 2010 (PLN) |
|---|---|---|
| Current income tax | (75) | (85) |
| Adjustment in respect of current income tax for the year 2003 ( Note 4) | (34,183) | - |
| Penalty interests relating to current income tax for the year 2003 ( Note 4) | (24,142) | - |
| Deferred income tax benefit / (charge), net | 6,245 | (2,996) |
| **Income tax charge** | **(52,155)** | **(3,081)** |

The deferred income tax calculation is based upon the probability that future taxable profit will be available against which temporary differences, unused tax losses and unused tax credits can be utilized. That calculation is based upon Management's estimates, which are subject to considerable uncertainty and the actual outcome may differ. These estimates may be altered to reflect changes in the economic, technological and competitive environment in which the Netia Group operates.

As of December 31, 2010 the Management updated its previous year's assessment regarding the recognition of deferred income tax. The new assessment concluded that the Netia Group expects that future taxable profits will be generated based on the 2011 budget and 2011-2015 long term business plan. Management's assessment also considered factors such as: the stability and trend of past earnings, the nature of the business and industry, and the economic environment in which the Netia Group is located. As at March 31, 2011 the Management upholds its assessment regarding future taxable profits and the recognition of deferred income tax.

(All amounts in thousands, except as otherwise stated)

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are as follows:

| | March 31, 2011 (PLN) | December 31, 2010 (PLN) |
|---|---|---|
| Deferred income tax assets: | | |
| - Deferred income tax assets to be recovered after more than 12 months | 82,601 | 74,596 |
| - Deferred income tax assets to be recovered within 12 months | 25,439 | 28,072 |
| | 108,040 | 102,668 |
| Deferred income tax liabilities: | | |
| - Deferred income tax liabilities to be recovered after more than 12 months | 15,850 | 16,390 |
| - Deferred income tax liabilities to be recovered within 12 months | 33,173 | 33,516 |
| | 49,023 | 49,906 |
| **Deferred income tax assets, net** | **59,017** | **52,762** |

The deferred income tax assets and liabilities consist of the following items:

| | March 31, 2011 (PLN) | December 31, 2010 (PLN) |
|---|---|---|
| Deferred income tax assets: | | |
| - Tax losses | 68,719 | 78,499 |
| - Accrued expenses | 16,307 | 14,044 |
| - Impairment provisions for receivables | 2,945 | 3,057 |
| - Depreciation and impairment | 19,515 | 5,884 |
| - Foreign exchange differences | 22 | 35 |
| - Other | 532 | 1,149 |
| | 108,040 | 102,668 |
| Deferred income tax liabilities: | | |
| - Depreciation and impairment | 33,329 | 34,301 |
| - Accrued revenue | 10,495 | 11,304 |
| - Interest | 831 | 805 |
| - Forward contract | 22 | 63 |
| - Other | 4,346 | 3,433 |
| | 49,023 | 49,906 |
| **Deferred income tax assets, net** | **59,017** | **52,762** |

The deferred income tax recognized in equity as at March 31, 2011 in the amount of PLN 41(PLN 391 as at December 31, 2010) relates to the hedging reserve.

Deferred income tax assets are recognized for deductible temporary differences and tax loss carry-forwards to the extent that the realization of the related tax benefit through the future taxable profits is probable. As of March 31, 2011, the Netia Group had total deductible temporary differences of PLN 115,509 and unutilised tax loss carry-forwards of PLN 373,365 (total potential deferred income tax asset of PLN 92,886).

The Netia Group did not recognize deferred income tax assets of PLN 2,220 relating to tax losses of PLN 11,683 of the Company's subsidiaries, due to insufficient likelihood of future taxable profits to realize these tax losses before they expire. These unrecognized tax losses of the Netia Group available for use as at March 31, 2011 will expire in the following years: PLN 18 in 2011, PLN 3,578 in 2012, PLN 2,921 in 2013,PLN 3,288 in 2014 and PLN 1,878 in 2015.

Furthermore, due to the lack of conclusive evidence of sufficient future taxable profits, the Netia Group did not recognize deferred income tax assets of PLN 31,649, relating to deductible temporary differences of PLN 166,573 as follows:

| | Timing differences (PLN) | Potential deferred income tax asset (PLN) |
|---|---|---|
| Depreciation and impairment | 159,326 | 30,272 |
| Deferred income | 7,247 | 1,377 |
| | **166,573** | **31,649** |

The Polish tax system has restrictive provisions for grouping of tax losses for multiple legal entities under common control, such as those of the Netia Group. Thus, each of the Company's subsidiaries may only utilize its own tax losses to offset taxable income in subsequent years. Losses are not indexed to inflation. Tax losses are permitted to be utilized over five years with a 50% utilization restriction per annum.

## 15. Dividends per share

No dividends have been proposed or paid in respect to the financial year ended December 31, 2010.

Management is proposing to the Annual Shareholders' Meeting that the whole profit for 2010 of PLN 267,032 and PLN 82,968 of distributable reserves classified as other supplementary capital be made available for the purposes of a share buyback programme to redeem up to 12.5% of the Company's share capital.

Netia's distributable reserves are disclosed in Note 10.

## 16. Supplemental disclosures to consolidated cash flow statement

***Changes in working capital components:***

| | Three-month period ended March 31, 2011 (PLN) | Three-month period ended March 31, 2010 (PLN) |
|---|---|---|
| Receivables | (23,616) | 11,100 |
| Inventories | 4,277 | (1,303) |
| Prepaid expenses | 450 | (13,846) |
| Provisions, accruals and other payables | 13,517 | (12,362) |
| Deferred income | 6,601 | 2,088 |
| | **1,229** | **(14,323)** |
| *Out of which:* | | |
| *Change in long -term position* | *(1,191)* | *1,617* |

***Supplemental disclosures to operating activities:***

| | Three-month period ended March 31, 2011 (PLN) | Three-month period ended March 31, 2010 (PLN) |
|---|---|---|
| Income taxes paid | (74) | (26) |
| Interest received | 3,113 | 1,633 |

## 17. The Management Board and Supervisory Board

***Management Board***

As at March 31, 2011 and December 31, 2010 the Company's Management Board consisted of the following members:
- Mirosław Godlewski – President,
- Jonathan Eastick – Chief Financial Officer,
- Grzegorz Esz,
- Piotr Nesterowicz,
- Tom Ruhan.

***Supervisory Board***

As at March 31, 2011 and December 31, 2010 the Company's Supervisory Board consisted of the following members:
- Benjamin Duster – Chairman,
- George Karaplis – Vice-Chairman,
- Stan Abbeloos,
- Raimondo Eggink,
- Nicolas Maguin,
- Ewa Pawluczuk,
- Tadeusz Radzimiński,
- Jerome de Vitry.

## 18. Related party transactions

***Options granted to members of the Management Board (not in thousands)***

As at December 31, 2010, the total number of options granted to members of the Company's Management Board under the 2003 Plan, was 40,771,814 of which 35,838,564 had vested as of that date. During the first quarter of 2011 the members of the Company's Management Board were granted a further 1,725,000 options under the New Plan, none of which had vested. Strike prices for the options granted to the Management Board range between PLN 3.50 and 8.25 per share. The market price of the Company's shares at December 31, 2010 was PLN 5.25 per share.

The movements in the number of options held by Members of the Company's Management Board are presented below:

| **Options** | **Three-month period ended March 31, 2011** | **Three-month period ended March 31, 2010** |
|---|---|---|
| At the beginning of the period | 40,771,814 | 40,771,814 |
| Granted | 1,725,000 | - |
| Exercised | (2,950,500) | - |
| At the end of the period | **39,546,314** | **40,771,814** |

As at March 31, 2011 Mr. Mirosław Godlewski – the Company's President of the Management Board – held 12,775,000 options, out of which 12,200,000 had vested as at March 31, 2011. As at December 31, 2010 Mr. Mirosław Godlewski held 13,334,000 options, out of which 13,334,000 had vested as at December 31, 2010.

As at March 31, 2011 Mr. Jonathan Eastick – a member of the Company's Management Board – held 10,359,314 options, out of which 10,071,814 had vested as at March 31, 2011. As at December 31, 2010 Mr. Jonathan Eastick held 10,938,314 options, out of which 10,938,314 had vested as at December 31, 2010.

As at March 31, 2011 Mr. Grzegorz Esz – a member of the Company's Management Board – held 4,454,000 options, out of which 2,233,250 had vested as at March 31, 2011. As at December 31, 2010 Mr. Grzegorz Esz held 4,166,500 options, out of which 1,433,250 had vested as at December 31, 2010.

As at March 31, 2011 Mr. Piotr Nesterowicz – a member of the Company's Management – held 6,954,000 options, out of which 6,666,500 had vested as at March 31, 2011. As at December 31, 2010 Mr. Piotr Nesterowicz held 6,666,500 options, out of which 4,466,500 had vested as at December 31, 2010.

As at March 31, 2011 Mr. Tom Ruhan – a member of the Company's Management Board – held 5,004,000 options, out of which 4,716,500 had vested as at March 31, 2011. As at December 31, 2010 Mr. Tom Ruhan – held 5,666,500 options, out of which 5,666,500 had vested as at December 31, 2010.

***Number of shares held by members of the Management Board (not in thousands)***

As at March 31, 2011 and December 31, 2010 Mr. Mirosław Godlewski – the Company's President of the Management Board – held 393,716 and 10,000 shares of the Company, respectively.

As at March 31, 2010 and December 31, 2010 Mr. Tom Ruhan – a member of the Company's Management Board – held 253,593 shares of the Company. Following the issuance of the Company's shares on April 6, 2011 (see Note 21), Mr. Tom Ruhan acquired 338,786 shares, increasing his holding to 592,379 shares as at the date of these consolidated financial statements.

As at March 31, 2011 and December 31, 2010, Mr. Jonathan Eastick – a member of the Company's Management Board – held 350,000 and 50,000 shares of the Company, respectively.

***Number of shares held by members of the Supervisory Board (not in thousands)***

As at March 31, 2011 and December 31, 2010, Mr. Raimondo Eggink – a member of the Company's Supervisory Board – held 40,000 shares of the Company.

As at March 31, 2010 and December 31, 2009, Mr. Tadeusz Radzimiński – a member of the Company's Supervisory Board – held 6,000 shares of the Company.

***Restricted Stock Units (not in thousands)***

As at March 31, 2011 the total number of Restricted Stock Units ("RSU") granted to the members of the Company's Supervisory Board was 520,000. RSUs entitle the holder to receive additional cash remuneration equal to the value of restricted stock units, which corresponds to the market price of the Company's shares. The vesting period for the RSU is three years from the date of grant. The Company recognizes the cost of cash-settled share-based payment transactions (including RSU) over the vesting period. The cost of RSU recorded in the three-month period ended March 31, 2011 amounted to PLN 212 thousands (PLN 145 thousands in the three-month period ended March 31, 2010).

***Management Board remuneration***

Compensation and related costs associated with members of the Company's Management Board during the three-month periods ended March 31, 2011 and 2010 amounted to PLN 1,750 and PLN 1,565, respectively. In addition, the gross cost of share-based payments in the amounts of PLN 592 and PLN 2,616 was recognized in the respective periods.

Compensation and related costs associated with members of the Management Boards of the Company's subsidiaries during the three-month periods ended March 31, 2011 and 2010 amounted to PLN 152 and PLN 418, respectively. These amounts were paid to certain employees of the Netia Group who are neither past nor present members of the Management Board of Netia S.A.

***Supervisory Board remuneration***

Compensation and related costs associated with members of the Company's Supervisory Board during the three-month periods ended

(All amounts in thousands, except as otherwise stated)

March 31, 2011 and 2010 amounted to PLN 210 and PLN 234, respectively.

Incidental expenses of the Supervisory Board Members reimbursed by the Company amounted to PLN 47 and PLN 50 during the three-month periods ended March 31, 2011 and 2010, respectively, and mainly related to travel and accommodation.

***Other transactions with related parties***

During the three-month periods ended March 31, 2011 and 2010, respectively the Netia Group has not been a party to any other material transactions, or proposed transactions, apart from transactions mentioned above, in which any member of the key management personnel or close members of their families, had or was to have a direct or indirect material interest.

## 19. Commitments

***Capital commitments***

Capital expenditures contracted for at the balance sheet date but not recognized in the consolidated financial statements amounted to PLN 30,586 as at March 31, 2011 and PLN 12,249 as at December 31, 2010 of which, PLN 3,708 and PLN 1,620 respectively, related to the planned acquisition of intangible assets.

## 20. Contingencies

***Universal services***

The telecommunications law stipulates that universal service obligation will be rested on telecommunications undertaking designated in the President of UKE decision issued upon carrying out of tender procedure. The President of UKE issued a decision designating TP SA to provide universal service until May 8, 2011. Telecommunications undertakings, whose revenue from telecommunications activity exceeded PLN 4,000, are obliged to participate in financing of this obligation. The exact participation amount of a telecommunications undertaking obliged to pay subsidy will be established by virtue of the President of UKE decision, as well, although the said amount cannot exceed 1% of revenues of a given telecommunications undertaking in a given calendar year. The amount of participation in subsidy towards the universal service will constitute cost of income acquisition under law on corporate income tax. At the present stage one cannot exclude that Netia Group will be obliged to co-finance subsidy towards universal services.

TP SA filed with the President of UKE applications for awarding subsidy towards incurred costs of universal service provision. The applications regard subsidy towards costs incurred in period from May 8, 2006, until December 31, 2006. The President of UKE refused to award TP SA with a subsidy towards costs of services provided by TP SA in 2006, being a part of universal service. Upon filing a complaint by TP SA the Court repealed the President of UKE decisions. The President of UKE and KIGEiT filed cassation appeals against this judgement. The appeals were dismissed by the Supreme Administrative Court and the case was remanded to UKE for reconsideration. TP SA filed applications for subsidies towards universal service for years 2007-2009, as well.

In view of uncertainties over data included in the calculation, currently it is impossible to provide a reliable estimation of potential obligations arising from the subsidy towards universal service. On the basis of the amount of subsidies claimed by TP SA and of the Company's estimations concerning revenues of telecommunications services providers that may participate in subsidies towards universal services, the amount of subsidy towards universal service that may be claimed by TP SA from Netia Group amounts to approximately PLN 27,000 for the period from 2006 until 2009 inclusive as follows:

| | |
|---|---|
| 2006 | 4,500 |
| 2007 | 7,000 |
| 2008 | 7,000 |
| 2009 | 8,500 |
| | **27,000** |

However, this amount may change substantially depending on (i) full or partial acceptance of TP SA applications by UKE and (ii) consistency of the Company's and UKE's estimations concerning revenues of telecommunications services providers. As Management is not aware of the size of any claim by TPSA in respect to 2010, it is still too early to estimate the related maximum amount.

The Management Board is unable to exclude the possibility of issuance of a decision, in result of which Netia will be designated to participate in universal service provision. However, in the opinion of the Management Board the list of investments claimed by TP SA does not currently justify such subsidies. Results of an independent audit of TP SA's claims conducted by UKE have not been published and no decisions of UKE in favor of TP SA have been made to date. As a consequence no reserve due to potential participation in universal service provision was established as at the balance sheet date.

***WiMAX license requirements***

On October 27, 2005 Netia WiMax S.A. (merged with Netia in 2006) and Netia WiMax II S.A. (merged with Netia in 2008) received the reservations of the 3.6-3.8 GHz frequencies, which are used to provide telecommunication services based on the WiMAX technology. The terms of licenses issued to the Company's former subsidiaries require them to meet annual connected capacity milestones in the future, as measured at the end of each year, subject to demand in the territory and population of Poland. Considering changes in the telecommunications market and, in particular, the advent of regulated access to the fixed line network of the incumbent fixed line operator, TP SA, the Company submitted applications to change future territorial and population coverage commitments for WiMax and on October 31, 2007 the Polish regulator issued a decision reducing the initial milestones. The amended milestones allotted for the years 2008 and 2009 regarding population coverage were exceeded whilst there was a marginal underperformance of the territorial coverage requirements. In the event that license obligations are not met by an operator, the UKE has the power to limit or confiscate the relevant license, if the issue is not rectified. However, historically such measures have rarely been used.

***Tax contingent liability***

Regulations relating to value-added tax, corporate income tax, and payroll (social) taxes have radically changed in comparison to the tax regulations, which existed prior to the economic and political transformation in Poland. The lack of reference to well-established practices and the relatively short period in which these new tax regulations have been in place often results in a lack of clarity and consistency in the regulations. Frequent contradictions in legal interpretations both within government bodies and between companies and government bodies create uncertainties and conflicts. Tax settlements, together with other areas of legal compliance are subject to review and investigation by a number of authorities, which are entitled to impose severe fines, penalties and interest charges. These facts create tax risks in Poland that are substantially more significant than those typically found in countries with more developed tax systems. The tax authorities may at any time inspect the books and records of the Company and may impose additional tax assessments with penalty interest and penalties within 5 years from the end of the year when a tax is due.

***Overpayment of tax (not in thousands)***

On February 19, 2010 Netia received a binding and enforceable decision of the Director of the Tax Chamber Director according to which the Company's corporate income tax due for the year 2003 was set at PLN 34.2m plus penalty interest of approximately PLN 25.3m.

Netia executed the decision of the Tax Chamber Director, which was enforceable as a decision of the second instance tax authority, on February 23, 2010. Of the PLN 59.6m paid, PLN 1.3m was subsequently conceded by the Tax Authority as overpayment. During 2010, Netia treated the overpaid tax as a receivable in its accounts rather than as an expense, due to Management's expectations, based on the expert advice received, that the amounts paid will ultimately be recovered.

The Company appealed to the Voivodship Administrative Court against the decision issued by the Tax Chamber Director. However, on March 15, 2011 the Voivodship Administrative Court delivered a judgment dismissing the Company's claim in its entirety. Following the WSA decision in favour of the tax office in the first quarter of the year 2011 the Company recognized an income tax expense relating to the year 2003 of PLN 58,325 thousands (see Note 4). The Company filed a motion for a written justification of the judgment and intends to file a motion for cassation to the Supreme Administrative Court.

Should the appeal to the Supreme Administrative Court be positive for the Company, the amount of unduly paid tax plus interest will be treated as an overpayment and must be returned by the tax authorities together with interest.

Netia will undertake all possible legal steps to prove that the decision of the Tax Chamber Director was groundless.

## 21. Subsequent events

***Issuance of series K shares (not in thousands)***

On April 6, 2011 due to the exercise of 2,001,372 stock options by one Management Board member, five persons who hold managerial positions (but not management board members) and one entitled person who held managerial position in the past (but not a management board member) in the three-month period ended March 31, 2011 the Company issued from its authorized capital 668,358 ordinary bearer series K shares with a nominal value of PLN 1 each, which give the right to 668,358 votes at Netia's General Meeting of Shareholders. These stock options were granted under 2003 Plan (please refer to Note 10). Netia's issued and outstanding share capital, following this issuance is PLN 391,042,968 and represents 391,042,968 shares, PLN 1 par value per share, each share giving the right to one vote at Netia's General Meeting of Shareholders.

***Purchase of Netia's shares (not in thousands)***

On April 8, 2011 the Company received a notification informing that ownership of Netia's shares held by clients of BZ WBK AIB Asset Management Spółka Akcyjna ("BZ WBK AIB") with its seat in Poznan has increased above the threshold of 5% of the total number of votes at Netia's General Meeting of Shareholders. BZ WBK AIB declared ownership of 19,644,773 shares which, taking into consideration the Company's outstanding share capital of PLN 391,042,968 at the date of these financial statements, amounts to 5.02% of share capital and 5.02% of votes at Netia's General Meeting of Shareholders.